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Making transnational law work through regime-building: the case of international investment law

JESWALD W. SALACUSE*

Introduction

Transnational law, in Philip Jessup's words, 'includes all law which regulates actions or events that transcend national frontiers'.[1] For Jessup, Detlev Vagts and others who established its foundations as a field of study, transnational law is not just about rules; it is especially about behaviour – not only the behaviour of States but also of corporate entities, private persons, and other non-State actors who engage in transactions transcending national boundaries. As scholars, their fundamental concern has not been just the nature of legal doctrine but the way transnational law works in practice. They have had a vision of international law that is dynamic, transactional, multidisciplinary and especially problem-focused. As Henry Steiner and Detlev Vagts write in the Preface to the 3rd edition of *Transnational Legal Problems*, their purpose is 'to develop a conceptual framework for understanding problems involving more than one legal and political system' and to study 'problems that are relevant not only to governments in their dealings with each other, but also to private participants, individual or corporate, in their relations to governments'.[2]

One of the ways in which transnational law becomes a reality in the sense of actually affecting the behaviour of both States and private parties is through the creation of international regimes. A regime, according to

* Jeswald Salacuse is privileged and grateful to have been a student of Detlev Vagts at Harvard.

[1] P. Jessup, *Transnational Law* (New Haven, CT: Yale University Press, 1956), 2.

[2] H. J. Steiner and D. F. Vagts, 'Preface', in H. J. Steiner and D. F. Vagts, *Transnational Legal Problems*, 3rd edn. (Westbury, NY: Foundation Press, 1986), xix.

one accepted definition consists of 'principles, norms, rules and decision-making procedures around which actors' expectations converge in a given area of international relations'.[3] For over two decades, international relations scholars have worked to develop a theory of regimes to explain the phenomenon of cooperation in an otherwise anarchic world. Although regime theory as a body of scholarly endeavour has been the almost exclusive province of political scientists, rather than international lawyers, some of its insights and frameworks may be useful in explaining how and why transnational law works in the way it does. Accordingly, this chapter will examine international investment law, a vitally important part of transnational law, through the lens of regime theory in an effort to understand how that law is made to work.

A background to international investment law

Since the end of the Second World War, the nations of the world have been engaged in building a global regime for investment through the negotiation of investment treaties. Investment treaties, often referred to as 'international investment agreements' (IIAs), are essentially instruments of international law by which States (1) make commitments to other States with respect to the treatment they will accord to investors and investments from those other States and (2) agree on some mechanism for the enforcement of those commitments. A fundamental purpose of investment treaties, as indicated by their titles, is to protect and promote investment.[4]

States undertook this effort to build an international regime for investment because they considered that the existing international law at the end of the Second World War did not offer the foreign investments of their nationals an adequate level of protection. At that time, foreign investors and their home governments seeking the protection of international investment law encountered an ephemeral structure consisting

[3] S. D. Krasner, 'Structural Causes and Regime Consequences. Regimes as Intervening Variables', *International Organization*, 36 (1982), 185–205.

[4] E.g. Treaty Concerning the Reciprocal Encouragement and Protection of Investment (United States–Armenia), 23 September 1992, s Treaty Doc. No. 1993103–11; Treaty Concerning the Promotion and Reciprocal Protection of Investments (Germany–Poland), 10 November 1989, *ILM*, 29 (1990), 333; Agreement for the Promotion and Protection of Investments (Indonesia–United Kingdom), 27 April 1976, Treaty Series No. 62. US BITs tend to refer to the 'encouragement of investment', rather than the 'promotion of investment'. Based on an analysis of BIT provisions, it appears that the two terms, 'encouragement' and 'promotion', have the same meaning.

of scattered treaty provisions, a few questionable customs and some contested general principles of law. Foreign investors considered the existing international legal structure to be seriously deficient in several respects. First, the applicable international law failed to take into account contemporary investment practices and needs and to address important issues of concern to foreign investors.[5] For example, customary international law had virtually nothing to say about the right of foreign investors to make monetary transfers from a host country or to bring foreign managers and technicians into a host country to operate their investments. Second, the principles that did exist were often vague and subject to varying interpretations. For example, although there was strong evidence that customary international law required the payment of compensation upon nationalisation of an investor's property, no specific principles had crystallised as to how that compensation was to be calculated.

Third, the existing international legal framework was a subject of strong disagreement between industrialised countries and capital-importing developing nations. For example, while capital-exporting States claimed that international law imposed an obligation on host countries to accord foreign investors a minimum standard of protection and required that States expropriating the property of foreign investors pay compensation, many non-Western countries denied the existence of such international rules. The Soviet Union's massive nationalisations without compensation of foreign investments at the time of the Russian Revolution and Latin America's Calvo doctrine represented long-standing challenges to Western views on the content of international investment law. With the advent of decolonisation after the Second World War, many developing countries, asserting that they had played no part in the development of Western conceptions of international law and believing that existing international rules served only to maintain their poverty, also challenged Western views of international

[5] In 1970, the ICJ in the *Barcelona Traction* case found it 'surprising' that the evolution of international investment law had not gone further and that no generally accepted rules had yet crystallised in light of the growth of foreign investments and the expansion of international activities by corporations in the previous half-century. *Case Concerning the Barcelona Traction, Light and Power Co., Ltd (Belgium* v. *Spain)*, 1970 ICJ Rep. 3, 46–7. As recently as 2004, one scholar of international investment law stated: 'There are few customs in this sense in the field of foreign investment', M. Sornarajah, *The International Law on Foreign Investment*, 2nd edn. (Cambridge University Press, 2004), 89.

investment law. They demanded that the international legal order take account of their particular needs and circumstances.[6] Their position on foreign investment was incorporated into Art. 2 of the 1974 United Nations Charter of Economic Rights and Duties of States,[7] which was adopted by the United Nations General Assembly over the opposition or abstention of developed countries.

Finally, existing international law offered foreign investors no effective enforcement mechanism to pursue claims against host countries that seized investments or refused to respect contractual obligations. As a result, investors had no assurance that investment contracts and arrangements made with host country governments would not be subject to unilateral change at some later time. An affiliate of the World Bank, the International Centre for Settlement of Investment Disputes under the International Convention for the Settlement of Disputes between States and Nationals of other States (ICSID) was formally established in 1966 to resolve disputes between host countries and foreign private investors,[8] but it required the specific consent of the parties to an ICSID Tribunal to exercise jurisdiction over an investor–State dispute. As a result, the Centre did not hear its first case until 1972. Injured foreign investors who were unable to negotiate a satisfactory settlement, secure an arbitration agreement with a host government, or find satisfaction in the local courts had few options other than to seek diplomatic protection from their home country governments. By its very nature, the process of diplomatic protection was more political than legal and, in any event, yielded results that were always uncertain and invariably slow.

[6] Inspired by the success of the oil-producing countries in raising petroleum prices in 1973–4, developing countries had hoped that by building a numerically strong coalition among themselves, they would be able to bring about desired change in various international fora. As a result of the debt crisis in the early 1980s, the internal economic restructuring demanded by international financial institutions (IFIs), such as the International Monetary Fund (IMF) and the World Bank, and the abandonment of command economy models by developing countries, the movement for a 'New International Economic Order' (NIEO) lost steam and was virtually dead by 1990. T. Wälde, 'Requiem for the "New International Economic Order"', in G. Hafner *et al.* (eds.), *Festschrift für Ignaz Seidl-Hohenveldern* (Cologne: C. Heymann, 1998), 771–804. See generally, J. Hart,*The New International Economic Order* (London: Macmillan, 1983); J. N. Bhagwati (ed.), *The New International Economic Order. The North–South Debate* (Cambridge, MA: MIT Press, 1977).

[7] UNGA Res. 3281 (XXIX), 12 December 1974; UN Doc. A/RES/3281 (XXIX) (1974); *ILM*, 14 (1975), 251.

[8] International Convention on the Settlement of Investment Disputes between States and the Nationals of other States, 18 March 1965; 17 UST 1270; 575 UNTS 159.

In sum, then, as global economic expansion began to accelerate in the years following the Second World War, the existing international law on foreign investment was for most foreign investors incomplete, vague, contested and without an effective enforcement mechanism. Because of these defects, investors and their home governments needed to find another means to protect foreign investments from the injurious actions of host country governments. To protect the interests of their companies and investors, capital-exporting countries sought to build an international regime for investment that, to the extent possible, would be: (1) complete, (2) clear and specific, (3) uncontestable and (4) enforceable. The means to achieve that end would lie in negotiating investment treaties.

The nature of investment treaties

The movement to negotiate investment treaties, driven by capital-exporting countries, began in the 1950s, has steadily gained momentum since that time and has taken place at both the bilateral and multilateral level among States.[9] Three basic types of investment agreements have evolved during that period: (1) bilateral investment treaties, commonly known as 'BITs', (2) bilateral economic agreements with investment provisions and (3) other investment-related agreements involving more than two States.

Bilateral investment treaties

BITs, as their name indicates, govern investment relations exclusively between two signatory States. As of the beginning of 2008, the total number of BITs in existence was 2,608, and 179 countries were parties to at least one of them.[10] The degree to which individual countries have participated in concluding BITs has varied. For example, 41 per cent of all BITs concluded as of 2008 were between a developing and a developed country, while only 9 per cent were between developed countries.[11] And while Germany, the first country to negotiate a BIT, had concluded

[9] For background on the investment treaty movement, see J. W. Salacuse and N. P. Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain', *HILJ*, 46 (2005) 68–75.

[10] UNCTAD, *World Investment Report 2008* (New York: United Nations, 2008) 14.

[11] *Ibid*., 16.

nearly 140 individual BITs as of 2008,[12] certain other States had ratified very few.

Bilateral economic treaties with investment provisions

In addition to BITs, which concern investment only, various other bilateral economic agreements also contain investment provisions. Among the most important of these are modern free trade agreements, such as those pursued by the United States,[13] and economic partnership and cooperation treaties, like those advanced by Japan,[14] which contain chapters on investment that replicate many, if not most, of the provisions in BITs. As of 2008, 254 such agreements were in existence. In addition, one must also consider earlier bilateral commercial and trade agreements, such as the Treaties of Friendship Commerce and Navigation negotiated by the United States with numerous countries, which often include provisions that affect foreign investments and can become the basis for international litigation to protect investor interests.[15] Many of these early treaties contain provisions, such as promises of 'full protection and security' that BITs would subsequently incorporate and develop.

Multilateral investment treaties

Investment treaties as a group include more than strictly bilateral agreements. Numerous treaties with more than two State parties set down important enforceable international rules concerning foreign investment. These include the North American Free Trade Agreement (NAFTA),[16] a treaty among the United States, Canada and Mexico, in which Chapter Eleven is itself an investment treaty, and the Energy

[12] *Ibid.*, 15.

[13] E.g. United States–Colombia Trade Promotion Agreement, 22 November 2006.

[14] M. Yasushi, 'Economic Partnership Agreements and Japanese Strategy', *Gaiko Forum*, 6, No. 3 (Fall 2006), 53.

[15] E.g. *Case Concerning Elletronica Sicula SpA (ELSI) (United States of America* v. *Italy)*, 20 July 1989, ICJ Rep., 15 (applying the 1948 Treaty of Friendship, Commerce and Navigation Between Italy and the United States); *Case Concerning Oil Platforms* (*Islamic Republic of Iran* v. *United States of America*), 6 November 2003, 1996 ICJ Rep., 803 (applying 1955 Treaty of Amity, Economic Relations, and Consular Rights between the United States and Iran).

[16] North American Free Trade Agreement (NAFTA, United States–Canada–Mexico), 17 December 1992, *ILM*, 32 (1993), 289.

Charter Treaty,[17] a multilateral convention among fifty-one countries setting down rules for trade and investment in the energy sector. Also included in the group of multilateral treaties are various regional international arrangements such as the Unified Agreement for the Investment of Arab Capital in the Arab States,[18] the ASEAN Agreement for the Promotion and Protection of Investments,[19] and Latin America's Mercosur.[20] The provisions of these agreements are remarkably similar to the BITs and were clearly influenced and informed by the BIT experience.

As a result of the surge in treaty-making undertaken by States since the end of the Second World War, the total number of treaties with meaningful provisions relating to foreign investment as of the beginning of 2009 probably exceeded 3,000. That number is certain to grow as States continue to negotiate significant numbers of investment treaties each year.[21]

Although each of the 3,000 investment treaties is legally separate and distinct and therefore binds only the States that have concluded them, investment treaties as a group bear a remarkable similarity to one another with respect to structure, purpose and principles. It is for this reason that one may view them, despite individual differences in their text, as constituting a single international regime for investment. For example, nearly all international investment agreements cover the following nine topics: (1) definitions and scope of application; (2) investment promotion and the conditions for the entry of foreign investment and investors; (3) general standards of treatment of foreign investors and investments; (4) monetary transfers; (5) expropriation and dispossession; (6) operational and other conditions; (7) losses from armed conflict or internal disorder; (8) treaty exceptions, modifications and terminations; and (9) dispute settlement. In addition, the language used in expressing these principles is often identical, so that it is not uncommon, for example, to find that both counsel and arbitrators will refer to arbitral

[17] European Energy Charter Treaty, *ILM*, 34 (1995), 360.

[18] 'Unified Agreement for the Investment of Arab Capital in the Arab States', in *Economic Documents* (Tunis: League of Arab States), No. 3, www.unctad.org/sections/dite/iia/docs/Compendium//en/36%20volume%202.pdf.

[19] ASEAN Agreement for the Promotion and Protection of Investments of 1987, *ILM*, 27 (1988), 612.

[20] Protocol of Colonia for the Promotion and Reciprocal Protection of Investments in Mercosur, 17 January 1994, MERCOSUR/CMC/DEC No. 11/93.

[21] For example, UNCTAD determined that in 2007 alone forty-four new BITs were signed and at least seventy non-BIT international investment agreements among 108 countries were under negotiation, UNCTAD, *World Investment Report*, *supra* n. 10, 15–16.

decisions in cases interpreting one type of investment treaty – for example, the investment chapter of NAFTA – to interpret a similar provisions in a totally separate and unrelated treaty, for example a BIT between Chile and Malaysia.[22]

An important support mechanism for this emerging international investment regime has been ICSID, which was formally established to resolve disputes between host countries and foreign private investors. Although ICSID, as we have seen, did not hear its first case until 1972, it has become an important institution for international investment dispute resolution. It is through the dispute resolution process that substantive treaty commitments toward investments and investors from other treaty countries are given meaning and made a reality.

The significance of investment treaties

The six decades since the end of the Second World War have thus witnessed a widespread *treatification*[23] of international investment law. Today, unlike the situation that prevailed before the Second World War, foreign investors in many parts of the world are protected primarily by international treaties, rather than by customary international law alone. For all practical purposes, treaties have become the fundamental source of international law in the area of foreign investment.[24] Indeed, in 2003, an Arbitral Tribunal that included a former president of the International Court of Justice (ICJ) suggested that the 2,000 BITs then in existence had shaped the customary international law with respect to the rights of investors.[25]

22 See, e.g., *MTD Equity Sdn Bhd & MTD Chile S A* v. *Republic of Chile*, ICSID Case No. ARB/01/7.

23 The word 'treatification', while not recognised by any standard English dictionaries, has been used on rare occasions. See, for example, the executive summary on missile proliferation on the web site of the Canadian Department of Foreign External Affairs. Foreign Affairs and International Trade Canada, www.dfait-maeci.gc.ca/arms/MTCR/page2-en.asp. The origin of this derivation of the word 'treatify' may perhaps be found in the 1908 Nobel lecture of the Peace Prize Laureate Frederik Bajer, who urged that a treaty be established to govern the canals between the North and Baltic seas, stating 'there is a need to "treatify", if I may coin this expression, the waterways – the French call them "canaux interocéaniques" – which connect the two seas'. See J. W. Salacuse, 'The Treatification of International Investment Law', *Law and Business Review of the Americas*, 13 (2007), 155–66.

24 P. Juillard, 'L'evolution des sources du droit des investissements', *RdC*, 250 (1994), 74–216.

25 *Mondev International Ltd* v. *United States of America*, ICSID Case No. ARB(AF)/99/2, NAFTA, Award, 11 October 2002, *ILM*, 42, 85, para. 125.

This shift from customary international law to treaty law in the domain of international investment has been anything but theoretical. For one thing, it has imposed a discipline on host country treatment of foreign investors. In those cases in which host governments have failed to abide by their commitments to investors, governments have found themselves involved in international arbitration proceedings (some 288 at the end of 2007[26]), and in many cases arbitral tribunals have held them liable to pay substantial damage awards to injured investors.[27] The decisions in investor–State arbitrations are becoming an increasingly important source of international jurisprudence on the respective rights of foreign investors and the States in which they invest.

In sum, international investment treaties are playing and will continue to play a growing role in international business and economic relations. An intensified knowledge of international investment treaties is therefore vital for government officials who negotiate, interpret and apply them, as well as for those who manage relations with actual and prospective foreign investors in their territories. Many officials and their government have learned at significant cost that international investment treaties are not just 'expressions of good will' but are binding instruments of international law that impose enforceable legal obligations on host country governments.

Similarly, international business executives, bankers and their lawyers must take account of relevant investment treaty provisions in planning, executing and managing foreign investment projects. International investment treaties have become, and will remain, vital elements in evaluating political risk in any country in which such professionals hope to operate. And when, as a result of changes in circumstance or policy, conflict arises between investors and host countries, international investment treaties usually play a significant role in their resolution. The treaty enforcement provision whereby individual investors are given the right to initiate arbitration against host countries has led to the development of an increasingly important area of legal practice. Law firms and practising lawyers need to understand, interpret and apply international

[26] UNCTAD, *World Investment Report*, *supra* n. 10, 16.

[27] One notable example is the case of *CME Czech Republic B V* v. *The Czech Republic*, an UNCITRAL arbitration under The Netherlands–Czech Republic BIT, which resulted in an award and payment of $355 million to an injured investor in 2003, one of the largest awards ever made in an arbitration proceeding up to that time, 14 March 2003, Final Award; P. Green, 'Czech Republic Pays $355 Million to Media Concern', *New York Times*, New York, May 16, 2003, W1.

investment treaties in order to effectively advise clients and represent them before arbitral tribunals – and, in some cases, national courts. Thus, international investment agreements have a growing significance for the conduct of international business, finance and legal practice.

But beyond the application of specific treaties to individual investors, one may well ask: What is the significance as a whole of all of this treaty-making over the last six decades? Just what does it all add up to? On the one hand, certain scholars have said that each of these 3,000 treaties are *lex specialis* that do nothing more than define specific rules for regulating investments between individual pairs of countries that are parties to the treaties.[28] According to this view, the whole is merely the sum of its parts. On the other hand, in view of the strong similarity among treaties and the common concepts, language, structure and processes they employ, other scholars have argued that given the large number of countries involved in the movement to negotiate international investment agreement these treaties constitute customary international law.[29] This debate is not new. Indeed, virtually since the beginning of the BIT movement, scholars have debated the extent to which BITs constitute or form customary international law with respect to foreign investment. One argument is that BITs 'establish and accept and thus enlarge the force of traditional conceptions' of the law of State responsibility for foreign investment.[30] Others have countered that, despite their prevalence, BITs have effect only between the parties to them because they are not sufficiently uniform to establish custom accepted by the international community.[31]

A regime for international investment

Without resolving the debate as to whether or not investment treaties constitute customary international law, one may conceptualise the mass of investment treaties made over the last sixty years in yet another way. Borrowing from international relations theory, one can think of the

[28] E.g. Sornarajah, *The International Law on Foreign Investment*, *supra* n. 5, 267.

[29] A. Lowenfeld, 'Investment Agreements and International Law', *Columbia Journal of Transnational Law*, 42 (2003), 12; S. M. Schwebel, 'The Influence of Bilateral Investment Treaties on Customary International Law', *Proceedings of the 98th Annual Meeting of the American Society of International Law* (2004), 27–30.

[30] F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, *BYBIL*, 52 (1981), 241–9, 249.

[31] B. Kishoiyian, 'The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law', *Northwest Journal of International Law & Business*, 14 (1994), 327–9, 329; Sornarajah, *The International Law on Foreign Investment*, *supra* n. 5, 267.

existing body of investment treaties as constituting a *regime*. As indicated at the outset of this chapter, a leading scholar of international relations has defined an international regime as 'principles, norms, rules and decision-making procedures around which actors' expectations converge in a given area of international relations'.[32] International regimes, according to two other scholars, 'constrain and regularize the behavior of participants, affect which issues among protagonists are on and off the agenda, determine which activities are legitimized or condemned, and influence where, when, and how conflicts are resolved'.[33]

Regimes, then, are instances of international cooperation in an otherwise anarchic world of independent sovereign States. States form international regimes in order to deal with problems in a manner that advances their interests. Their aim in building a global investment regime has been to facilitate the flow of capital and related technology among States so as to promote economic development and prosperity by solving the problem of foreign investment insecurity caused by the risk of adverse actions by governments in host countries. The basic building block for this emerging international investment regime has been the investment treaty.

The application of regime theory to examine the mass of investment treaties has the advantage of capturing the dynamics of the relationships established by these treaties among States and their nationals and of highlighting the systemic nature of what States have created through the investment treaty-making process. Examining the accumulated treaties through the lens of treaty analysis alone, on the other hand, yields a static picture that does not fully reflect the dynamism and fluidity of the resulting system that such treaties have created.

The application of regime theory to investment treaties

Regime elements

Following the 'consensus definition' quoted above, a regime consists of four elements: (1) principles; (2) norms; (3) rules; and (4) decision-making processes.[34] Each of these elements is examined below in connection with the regime created by investment treaties.

[32] Krasner, 'Structural Causes', *supra* n. 3, 2.

[33] D. J. Puchala and R. F. Hopkins, 'International Regimes. Lessons from Inductive Analysis', *International Organization*, 36 (1982), 245–76.

[34] A. Hasenclever *et al.*, *Theories of International Regimes* (Cambridge University Press, 1997), 9.

Regime principles

The first element of a regime is principles. By 'principles', regime theorists mean something different from what lawyers and legal scholars usually understand by that term. Within the context of international regimes, principles may be defined as 'beliefs of fact, causation, and rectitude'.[35] Regimes are based on a belief by their participants that cooperation in a particular area will lead to some desired outcome. Thus, for example, one may say that a regime for the prevention of nuclear proliferation is based on the principle that the proliferation of nuclear arms increases the likelihood of nuclear war and that a regime to control proliferation will achieve the desired outcome of reducing that likelihood.[36] What, then, are the principles upon which the international investment regime is based? An examination of investment treaty texts indicates a set of more or less common principles that the participating States have believed in negotiating them.

A first principle is the belief that increased investment between and among contracting States will increase their prosperity, economic development and business activity, and will lead to heightened economic cooperation among them.[37] Thus, the treaties' ultimate goal, as envisioned by their contracting States, is not just to increase the flow of capital and to protect individual investors.

A second principle is that favourable conditions in host States will, all other things being equal, lead to increased investment. The reference to 'favourable conditions' does not merely mean the natural state of things; it refers in particular to conditions that can be affected by host government actions and it recognises that such actions can either encourage or discourage investment. Thus, the title of virtually all investment treaties states that the agreement is to 'promote' or 'encourage' investment, and the targets of that promotion are investors of the other contracting party.

[35] Krasner, 'Structural Causes', *supra* n. 3.

[36] H. Muller, 'The Internationalization of Principles, Norms, and Rules by Governments. The Case of Security Regimes', in V. Rittberger (ed.), *Regime Theory and International Relations* (Oxford: Clarendon Press, 1993), 361–8. See also Hasenclever, *Theories of International Regimes*, *supra* n. 34.

[37] For example, the preamble to 1995 BIT between Mongolia and Singapore States: 'RECOGNIZING that the encouragement and reciprocal protection of such investments will be conducive to stimulating business initiative and increasing prosperity in both States', Agreement Between the Government of Mongolia and the Government of the Republic of Singapore on the Promotion and Protection of Investments, 24 July 1995.

A third principle of the investment regime is that the law and administrative decisions of host States can influence investment by giving increased predictability to the rules under which investors make their investments and conduct their activities. Underlying this principle, one may cite the work of the noted German sociologist, Max Weber, who sought to understand why capitalism arose in Europe. He concluded that one of the reasons was the nature of European law, which allowed what he called the 'calculability' of transactions. Weber emphasises the role that law plays in raising the probability that actions will take place. Calculability, according to Weber, encourages investment transactions. For Weber three conditions were necessary for law to be calculable: (1) the legal text must lend itself to prediction; (2) the administration and application of the legal text must not be arbitrary; and (3) contracts must be enforced.[38] Similarly, the goal of investment treaties has been to increase the calculability of foreign investment transactions

A fourth principle underlying the treaty regime is that the means to promote investment is to protect it. The promise of investment protection results in investment promotion. Thus the titles of nearly all investment treaties state that their purpose is not only to promote investment, but to protect it. The connection between promotion and protection lies in investor concepts of risk and predictability.

The general premise of investment treaties is that investment promotion is to be achieved by the host country's creation of a stable legal environment that favours foreign investment. The basic working assumption upon which investment treaties rest is that clear and enforceable rules that protect foreign investors reduce investment risk, and a reduction in risk, all other things being equal, promotes investment. Investment treaties, on the other hand, do not generally bind a home country to encourage its nationals and companies to invest in the territory of a treaty partner.

The risk for any foreign investor is that once the investment is made the host State may change the rules. A sudden, unexpected change in the rules is a principal form of political risk, perhaps its very essence. In order to encourage investment within their territories, host States make various kinds of commitments to investors in many different ways, including the provisions of foreign investment codes, investment agreements, development contracts, public service concessions and tax stabilisation

[38] R. Swedberg, 'Max Weber's Contribution to the Economic Sociology of Law', *Annual Revue of Law and Social Sciences*, 2 (2006), 61–81.

agreements, to mention only a few. Such instruments contain important commitments upon which investors rely in deciding to invest their capital in projects in the host country. The continuing respect by the State of such commitments is usually crucial for the profitability of the investment, and sometimes for its very survival. Since these arrangements are governed by the law of the host country and subject to the actions of its institutions, their continued stability faces the risk that the host government will unilaterally modify or terminate them at some later time, a phenomenon that has in fact taken place on numerous occasions. Such obligations made by host States to foreign investors are, in the oft-quoted words of the late Professor Raymond Vernon of the Harvard Business School, 'obsolescing bargains' between the investor and the host country.[39] The cause of their obsolescence has much to do with the decline in bargaining power of the investor during the life of the investment, and with changes in circumstance within the host country. At the time that an investor is proposing an investment to a country, the investor has a certain amount of bargaining power with the host government to secure favourable treatment and conditions for its investment: however, once the investor makes the investment and thereby places its capital under the sovereignty of the host State, its bargaining power diminishes and the commitments received risk becoming obsolete in the eyes of the host government.

The fifth principle of the investment regime is that international rules with effective enforcement mechanisms will deal with the problem of the obsolescing bargain by restraining the actions of the host government towards foreign investment in its territory. Rules and enforcement mechanisms are seen as a basic means to protect investment.

Regime norms

Norms are the second element of a regime. Norms in regime theory are defined as 'standards of behavior defined in terms of rights and obligations'.[40] Accordingly, investment treaties specify standards of 'treatment' (a term of art in all investment treaties) that host States are obligated to accord to investors and investments from their treaty partners.

[39] R.Vernon, *Sovereignty at Bay. The Multinational Spread of US Enterprises* (New York: Basic Books, 1971), 46.

[40] Krasner, 'Structural Causes', *supra* n. 3.

In order to protect foreign investors against the political risk resulting from placing their assets under host country jurisdiction, investment treaties include obligations with respect to the 'treatment' that host countries must give to investors and their investments. Although the treaties do not usually define the meaning of 'treatment', that word in its ordinary dictionary sense includes the 'actions and behaviour that one person takes toward another person'. By entering into an investment treaty, a State makes promises about the actions and behaviours – that is, the treatment – it will give to investments and investors of its treaty partners in the future.[41] The treaty provisions on investor and investment treatment are intended to restrain host country government behaviour and to impose a discipline on governmental actions. They seek to achieve this goal by defining a *standard* to which host countries' governments must conform in their treatment of investors and investments. State actions that fail to meet the defined standard constitute treaty violations that engage the offending State's international responsibility and render it potentially liable to pay compensation for the injury it has caused.

The standards of treatment – that is, the norms of the regime – bear a remarkable similarity in language and concept among investment treaties. Thus, nearly all investment treaties require host States to respect the norms of 'fair and equitable treatment', 'full protection and security', 'most-favoured-national (MFN) treatment', 'national treatment' and 'non-discriminatory treatment' with respect to protected investors and their investments. At the same time, it should be emphasised that treatment standards in treaties are almost always expressed in general and even vague terms so as to render difficult the task of applying them to concrete, complex fact situations of the type that usually arise in investment disputes. Indeed, the stated norms of the regime are breathtaking in their generality, vagueness and lack of specificity. The application of these vague norms in investment treaties has been the work of investor–State arbitration tribunals, the primary decision-making bodies of the international investment regime.

One norm in particular appears consistently in investment treaties and has become 'an almost ubiquitous presence in investment litigation':[42]

[41] In *Suez*, the Tribunal defined 'treatment' as follows: 'The word "treatment" is not defined in the treaty text. However, the ordinary meaning of that term within the context of investment includes the rights and privileges granted and the obligations and burdens imposed by a Contracting State on investments made by investors covered by the treaty.' *Suez, Sociedad General de Aguas de Barcelona SA and Vivendi Universal SA* v. *The Argentine Republic*, ICSID Case No. ARB/O3/19, Decision on Jurisdiction, 3 August 2006, para. 55.

[42] R. Dolzer, 'Fair and Equitable Treatment. A Key Standard in Investment Treaties', *The International Lawyer*, 39 (2005), 87.

fair and equitable treatment. Indeed, it is so prevalent that one may say the term 'fair and equitable treatment' seems to be viewed by contracting States as the basic standard of treatment to be accorded to investors. Indeed, to borrow the terminology of Hans Kelsen,[43] it is no exaggeration to say that the obligation of a host State to accord fair an equitable treatment to foreign investors is the *Grundnorm* or basic norm of the international investment regime. The basic purposes of investment treaties, as stated in their titles, are to promote and protect investments. Certainly, neither of those purposes could be achieved if treaties promised foreign investors treatment that was less than fair and less equitable.

Regime rules

Rules are the third element of a regime. For purposes of regime theory, rules are defined as 'specific prescriptions or proscriptions for actions'.[44] Although the difference between a 'norm' and a 'rule' is not always clear, one finds rules, in the form of prescriptions for action, in two places in the investment regime. First, the treaty texts contain many specific prescriptions for action. Thus, in addition to norms, the treaties express rules about such matters as expropriation, monetary transfers and compensation of injured investors because of war, revolution and civil strife. The second set of rules lies in the decisions of arbitral tribunals which apply the regime norms to specific fact situations. For example, fair and equitable treatment, according to many investment tribunals, means that the host government must respect 'the legitimate expectations' which it has created in the investor.[45] Indeed, one cannot fully know or understand the rules of the investment regime without studying the decisions of the arbitral tribunals that have applied often vague treaty terms to concrete fact situations.

Regime decision-making

The fourth and final regime element is decision-making procedures, which are defined as 'prevailing practices for making and implementing collective choice'.[46] The international regime for investment has no

[43] H. Kelsen, *Pure Theory of Law* (Berkeley, CA: University of California Press, 1978).
[44] Krasner, 'Structural Causes', *supra* n. 3.
[45] See R. Dolzer and C. Schreuer, *Principles of International Investment Law* (Oxford University, 2008), 119–49.
[46] Krasner, 'Structural Causes', *supra* n. 3.

centralised governing council with the power to administer and apply its rules, or the authority to make and implement collective choice. In that respect, it is unlike other international regimes such as the European Union (EU), the World Trade Organization (WTO), or the United Nations. Decision-making processes and authority are decentralised and diffused throughout the investment regime by individual treaties. Investment treaties provide for decision-making in basically four ways: (1) by consultation between the State parties to the treaty; (2) by arbitration between State parties in cases where they are unable to resolve conflicts through consultation and negotiation; (3) by consultations and negotiations between the investor and the State; and (4) by investor–State arbitration.

This last decision-making procedure has become the most important of the four. It is a unique feature of the regime, for two reasons. First, there are few instances in the international system where international law gives private persons and companies the right to compel a sovereign State to appear before a Tribunal and defend its sovereign actions, ostensibly taken to protect the public interest. The WTO, for example, has dispute resolution processes, but States, and States alone, are participants in those processes. Thus, the global investment regime has granted a private right of action to investors and has thereby also privatised the decision process to a large extent since arbitrators are private persons compensated by the disputants, not officials of governments or international organisations. Second, it is within investor–State arbitrations that most important decisions about the regime are decided. The first two of the abovementioned decision-making processes, while they exist in treaty law, are rarely employed by States. One exception is the North American Free Trade Agreement (NAFTA), which has created a Free Trade Commission (FTC) with the power to make binding interpretations of NAFTA provisions that NAFTA tribunals must follow in rendering their decisions.[47]

The decisions of arbitral tribunals in the nearly 300 investor–State disputes that have arisen under investment treaties have not only resolved a vast array of investor–State conflicts but they have also shaped the rules and norms of the regime. International law contains no doctrine of binding precedent, making the decisions of an international judicial or arbitral body in one case binding upon international judicial or arbitral

[47] Articles 2001–2002 NAFTA. The Commission has exercised this power on occasion. See NAFTA Free Trade Commission, *Notes of Interpretation of Certain* Chapter 11 *Provisions*, 31 July 2001.

bodies deciding similar, future cases.[48] Art. 59 of the Statute of the ICJ specifically states that '[t]he decision of the Court has no binding force except between the parties and in respect of that particular case'. Similarly, Art. 1136(1) of NAFTA, in virtually identical language, makes it clear that decisions of investment arbitral tribunals under Chapter 11 do not constitute binding precedent for the future. The treaty states '[a]n award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case'. Neither the ICSID Convention nor individual investment treaties contain a similarly specific prohibition, but neither do they expressly recognise that investment arbitration awards constitute precedent.[49] On the other hand, Art. 38 (d) of the Statute of the ICJ, in defining the sources of international law, recognises 'judicial decisions and the teachings of the most highly qualified publicists of the various nations as subsidiary means for the determination of rules of law'.[50] Thus, in applying international law international, courts and tribunals may refer to previous judicial decisions and arbitral decisions to determine the applicable rules of international law.

In international investment arbitration, counsel for the parties regularly cite prior cases in support of their positions, and tribunals, while reaffirming that they are not bound by previous arbitral decisions and awards, nonetheless constantly refer to earlier awards and decisions in interpreting investment treaty provisions and deciding investment disputes. Various factors have supported this trend. First, the vague and general language of many investment treaties, and the fact that treaties employ common legal concepts and phrases, naturally leads lawyers and tribunals to refer to decisions in other cases to determine how such provisions should be interpreted. Second, a recognised goal of international investment law is to establish a predictable, stable legal framework for investments, a factor which causes tribunals to pay attention to previous decisions on similar issues. Third, tribunals, like courts, are motivated by the underlying moral consideration that 'like cases should

[48] G. Kaufmann-Kohler, 'Arbitral Precedent. Dream, Necessity or Excuse?', *Arbitration International*, 23 (2007), 357.

[49] Art. 53(1) ICSID Convention States: 'The award shall be binding on the parties.' Schreuer suggests that this provision may be interpreted as 'excluding the applicability of the principle of binding precedent to successive ICSID cases'. He also notes that there is nothing in the preparatory work of the Convention suggesting that the doctrine of precedent should be applied to ICSID arbitration. C. Schreuer, 'A Doctrine of Precedent?', in P. Muchlinksi *et al.* (eds.), *The Oxford Handbook of International Investment Law* (Oxford University Press, 2008), 1190.

[50] Art. 38(1)(d) ICJ Statute.

be decided alike', unless a strong reason exists to distinguish the current case from previous ones.

The growth in investor–State arbitration in recent years has led to a significant expansion in the jurisprudence of investment treaties. The commonality of language and provisions among investment treaties makes an understanding of judicial and arbitration decisions important to their interpretation and application. Thus, this essentially private method of decision-making has played a crucial role in the development and maintenance of the regime set in place by investment treaties.

Why have States chosen to privatise this important method for implementing collective choice concerning the investment regime? No doubt capital-exporting countries believed that granting investors a private right of action for violation of regime rules would be an effective way of assuring that such rules were respected. But investor–State arbitration as a decision-making procedure has another advantage for home countries: it is a way for capital-exporting governments to reduce the governmental transaction costs arising out of the investments made by their nationals. Under the previous systems, government had to deal with their nationals seeking diplomatic protection and other forms of interventions with host country governments. That method potentially entailed significant diplomatic, political and economic costs since it might impact on and complicate important multi-faceted international relationships between a host State and an investor's home State. Investor–State arbitration relieves home countries of those costs. In effect, it allows them to say to their nationals and companies aggrieved by host government acts: 'You have your own remedy in the treaty. Use it if you wish. Go away and don't bother us.'

A different kind of regime

While the approximately 3,000 investment treaties together would seem to meet the definition of an international regime, one must acknowledge that this emerging regime has significant differences from other international regimes. Two of the most important are, first, that the regime has largely been constructed bilaterally, rather than multilaterally and, second, that it gives broad scope to private decision-making.

Bilateral construction

First, the investment regime has been constructed largely through bilateral negotiations, rather than multilateral ones. Most other international

regimes – like the WTO, the International Criminal Court (ICC), the international human rights regime and the nuclear non-proliferation regime – have been the product of multilateral, indeed global, negotiations. Thus, for example, at the same time that the nations of the world have been building a global regime for investment, they have also been hard at work developing an international trade regime, primarily through the General Agreement on Tariffs and Trade (GATT)[51] and, since 1995, the WTO.[52] But whereas the trade regime has been developed on a *multilateral* basis through a succession of multilateral negotiating rounds leading to multilateral conventions, the investment regime has been built largely on a *bilateral* basis as numerous pairs of countries have negotiated similar rules and enforcement mechanisms that apply to their nationals and their investments in the territory of the other country. On the other hand, efforts to negotiate a global treaty on investment, such as the OECD initiative to conclude a Multilateral Investment Agreement (MIA), have failed.[53]

An interesting question is *why* the nations of the world have been willing to conclude bilateral investment treaties in growing numbers over the last fifty years but have generally resisted global agreements on investment. There is both a technical and a political explanation for this. The technical explanation is that a bilateral treaty must accommodate the interests of only two parties and is therefore far less complicated to negotiate than a multilateral, global treaty, which must accommodate the interests of many countries.[54] The political explanation is that, given the asymmetric nature of bilateral negotiations between a strong, developed country and a usually much weaker developing country, the bilateral setting allows the developed country to use its power more effectively than does a multilateral setting, where that power may be much diluted. For example, in multilateral settings, developing countries have the

[51] General Agreement on Tariffs and Trade, *opened for signature* on 30 October 1947, 55 UNTS 308.

[52] Agreement Establishing the World Trade Organization, Marrakesh, 15 April 1994.

[53] OECD, Multilateral Agreement on Investment: *The Original Mandate*. See also G. Kelley, ‘Multilateral Investment Treaties. A Balanced Approach to Multinational Corporations’, *Columbia Journal of Transnational Law*, 39 (2001), 483.

[54] For a discussion of the differences between bilateral and multilateral negotiations, see F. O. Hampson, *Multilateral Negotiations. Lessons from Arms Control, Trade, and the Environment* (Baltimore, MD: Johns Hopkins University Press, 1995), 1–51, 345–60; I. W. Zartman (ed.), *International Multilateral Negotiation. Approaches to the Management of Complexity* (San Francisco, CA: Jossey-Bass, 1994), 1–10, 213–22.

opportunity to form blocking coalitions with like-minded States to enhance their power in the negotiations, something that is impossible in bilateral negotiations. Moreover, the prospects of investment capital from specific developed countries, along with other political and economic benefits arising from a definite bilateral relationship, may make a developing country more willing to enter into a BIT with a specific developed country than it would a multilateral agreement where those benefits may seem more tenuous and theoretical. Moreover, whereas developed countries would be willing to enter into bilateral treaties with developing countries for investment liberalisation, knowing full well that little if any enterprises from the developing country would ever invest in the developed State, they have been unwilling to enter into treaties that would grant such liberalisation to investors from other developed States, who could become strong competitors to the host countries' own enterprises.[55]

Viewed from a different perspective, one may also say that the 2,600 bilateral investment treaties, although bilateral in form, have not really been negotiated on a strictly bilateral basis. One may view them as the product of 'serial multilateralism', instead of the traditional 'conference multilateralism' which has produced most of the world's international regimes. That is to say, capital-exporting States, which have driven the treaty-making process, have done so on the basis of prepared models or prototypes which they then proceeded to negotiate with many individual countries, showing little willingness to deviate significantly from the model they had prepared. Thus, from the outset, those capital-exporting States contemplated engaging in a multilateral process of negotiating with other States one at a time.

The similarity in models used by capital-exporting States has, of course, led to a similarity in treaties actually concluded. What explains the similarity of the models that States have used to negotiate BITs? Do they represent a grand conspiracy among capital-exporting States? Certainly there has been communication among capital-exporting States over the years as they have developed and refined their models. But an even more important factor has helped to shape the investment treaty regime: the epistemic community of international lawyers and scholars. Epistemic communities are defined as 'networks of professionals with recognised expertise and competence in a particular domain

[55] Such a problem arose during the negotiation of the failed OECD MIA, conducted between 1995 and 1998. See Kelley, 'Multilateral Investment Treaties', *supra* n. 53.

and an authoritative claim to policy relevant knowledge within that domain or issue area'.[56] Epistemic communities are vital to regime creation and maintenance because, according to Haas, they 'are crucial channels through which new ideas circulate from societies to government as well as from country to country'.[57] Since the movement to negotiate investment treaties began, the epistemic community of international lawyers, scholars, jurists and arbitrators has through their advising, writing, advocacy and judicial and arbitral decisions shaped the regime. They are now the principal actors for maintaining and operating it.

Privatised decision-making

A second important difference from other international regimes is the strong roles that non-State actors play in formulating, elaborating and applying the rules of the regime. In effect, the investment regime 'privatises' decision-making, whereas in other regimes, such as the WTO, decision-making remains firmly in the hands of Member States.

In most other regimes, States and their representatives are entrusted with the crucial function of elaborating and defining the rules of the regime. Thus, for example, State representatives may meet periodically to negotiate new rules, and institutions under the control of States are usually entrusted with the task of applying those rules to specific cases. A similar model of decision-making does not prevail in the international investment regime. Instead the regime, through investment treaties, has delegated decision-making to private persons – arbitrators, who are not representatives of States, and are not, unlike diplomats, able to pursue State policy. Indeed, arbitral rules of conduct require them to decide and act 'independently', which means that they may not be influenced by States, governments, the parties, or anybody else for that matter. Other private parties – lawyers and law firms representing investors and States – also play an important role in the decision-making process. Through their advocacy, they strongly influence both the process of decision-making and its end result. Thus, to a significant extent, regime elaboration and operation are largely in the hands of private parties who are not accountable to the States that have created the regime.

[56] P. Haas, 'Introduction: Epistemic Communities and International Policy', in P. Haas, 'Introduction: Epistemic Communities and International Policy Coordination', *International Organization*, 46 (1992), 1–35, 3.
[57] *Ibid*., 27.

In theory, of course, arbitrators only decide disputes. They have no authority to make rules, and their decisions do not formally constitute legal precedent. But in practice, the approximately 300 decisions that have emanated from tribunals are consistently cited by lawyers and other tribunals and have a powerful influence on the making of future regime decisions.

Regime challenges

Regime theorists recognise that regimes are not permanent. The fact that at a given moment in time the parties' expectations may have 'converged' around a given set of principles, norms, rules and decisions in the investment area of international relations to form a regime does not mean that those expectations have converged permanently. Thus, despite the fact that the international investment regime is founded on 3,000 treaties solemnly concluded by some 180 different States, one cannot assume that it will endure.

For regime theorists, the endurance of a regime depends on two factors: regime effectiveness and regime robustness.[58] 'Regime effectiveness' requires the continued willingness and ability of its members to abide by its rules and to pursue its objectives and purposes. 'Regime robustness' refers to the ability of the regime to withstand external threats and challenges. The effectiveness and robustness of the international investment regime is by no means assured. It faces four salient challenges: two internal to the regime, and two external.

(1) The investment regime has been founded on the assumption that it will increase international investment, which in turn will lead to increased prosperity and economic development. Much research has questioned whether investment treaties have in fact increased investment flows to poor countries.[59] If the regime is ultimately judged not to have achieved its fundamental objective of promoting investment, then the justification for its continued existence becomes problematic.

(2) While public opinion generally seems to accept the norms and rules of the regime, its decision-making processes have been seriously

[58] Hasenclever, *Theories of International Regimes*, *supra* n. 34, 2.

[59] M. Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract FDI? Only a Bit . . . and They Could Bite', World Bank, Working Paper No. 3121, June 2003; Salacuse and Sullivan, 'Do BITs Really Work?', *supra* n. 9, 66.

called into question. Host governments and elements of civil society have challenged the decision-making process on many grounds: that it is not transparent, that it does not account for the disparity in economic situation of regime members, that arbitrators are not truly independent, that they have an investor bias and that their decisions infringe on the legitimate exercise of sovereignty by host States.[60] For these alleged reasons, Bolivia in 2007[61] and Ecuador in 2010[62] formally withdrew from ICSID, an important pillar of the regime.

(3) The 'Washington Consensus' – the shared belief or, in the language of regime theory, 'the converged expectations' of many countries from the late 1980s until the end of the 1990s, that increased investment, open economies, privatisation and economic deregulation would result in increased global prosperity and economic development – was a powerful force for the spread of investment treaties and the development of the regime that they created.[63] Many parts of the world have lost faith in the ability of the 'Washington Consensus' to bring prosperity, and they therefore are looking for alternative ways of economic development.[64] The shattering of the 'Washington Consensus' may constitute the loss of an important support for a global investment regime based on treaties.

[60] J. A. Van Duzer, 'Enhancing the Procedural Legitimacy of Investor–State Arbitration Through Transparency and Amicus Curiae Participation', *McGill Law Review*, 52 (2007); S. D. Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration. Privatizing International Law Through Inconsistent Decisions', *Fordham International Law Review*, 73 (2005), 1521; M. Sornarajah, 'A Coming Crisis. Expansionary Trends in Investment Treaty Arbitration', in K. Sauvant (ed.), *Appeals Mechanisms in International Investment Disputes* (New York: Oxford University Press, 2008), 39.

[61] ICSID News Release, 16 May 2007.

[62] ICSID News Release, 9 July 9 2009, announcing Ecuador's denunciation of the ICSID treaty with effect from 7 January 2010.

[63] The term 'Washington Consensus' is said to have been coined by economist John Williamson in 1989. It consisted of ten broad reforms: (1) fiscal discipline; (2) reordering public spending priorities away from politically powerful groups, such as the military, and toward basic services and infrastructure; (3) tax reform; (4) financial liberalisation; (5) competitive, stable exchange rates; (6) trade liberalisation; (7) reduction in barriers to foreign investment; (8) privatisation of State enterprises; (9) deregulation; and (10) property rights reform. S. Flanders, 'A New Washington Consensus', *The Financial Times*, 14 March 1997, 2. See also J. W. Salacuse, 'From Developing Countries to Emerging Markets. A New Role for Law in the Third World', *International Lawyer*, 33 (1999), 875.

[64] M. Hudson and J. Sommers, 'The End of the Washington Consensus', *CounterPunch*, December 12–14, 2008.

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(4) Serious regional and global economic crises, like the one that struck Argentina in 2001 and the entire world in 2008, pose important external threats to the international investment regime. Countries under great stress, faced with potential social and political upheaval as a result of rapidly declining standards of living, often seek radical solutions and are impatient with international investment rules that may restrict their scope for action. For example, during times of economic crisis, they may be unwilling to grant national treatment to foreign investors, to avoid changing regulations in the name of 'fair and equitable treatment' and to refrain from seizing vital national resources held by foreigners just because they have made treaty promises not to expropriate.

These threats are real and they have the potential power to cause a divergence of State expectations and thus undermine the regime that has been painstakingly constructed over the last sixty years. The international investment regime will require wise management and flexible leadership in the future if it is to withstand the challenges.